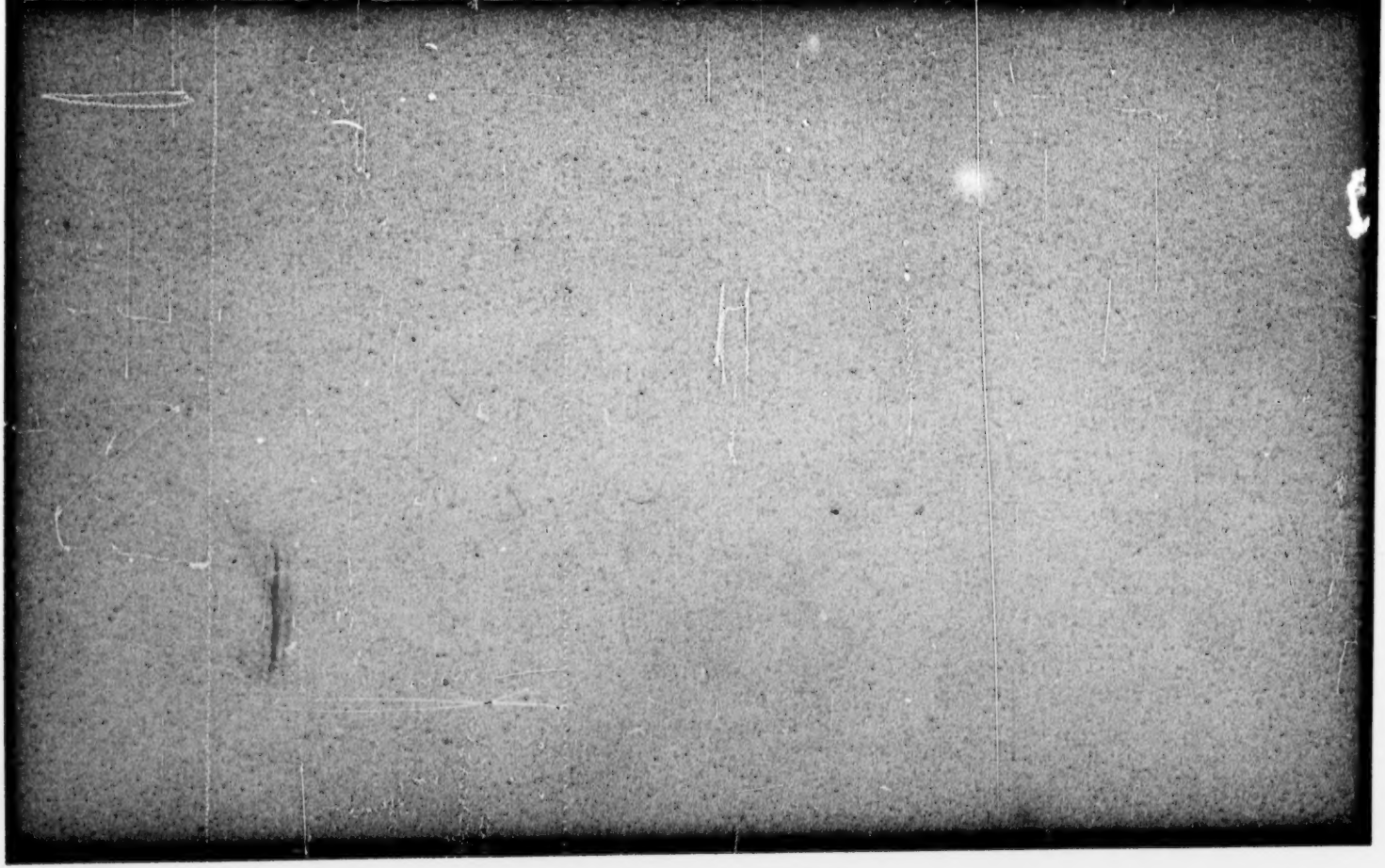

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Supreme Court of the United States

No. 73-1685
October Term, 1973

BERTHA ARBER and ANN ARBER BROEK,
Petitioners,

vs.

ESSEX WIRE CORPORATION and WALTER F. PROBST,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF OF PETITIONERS

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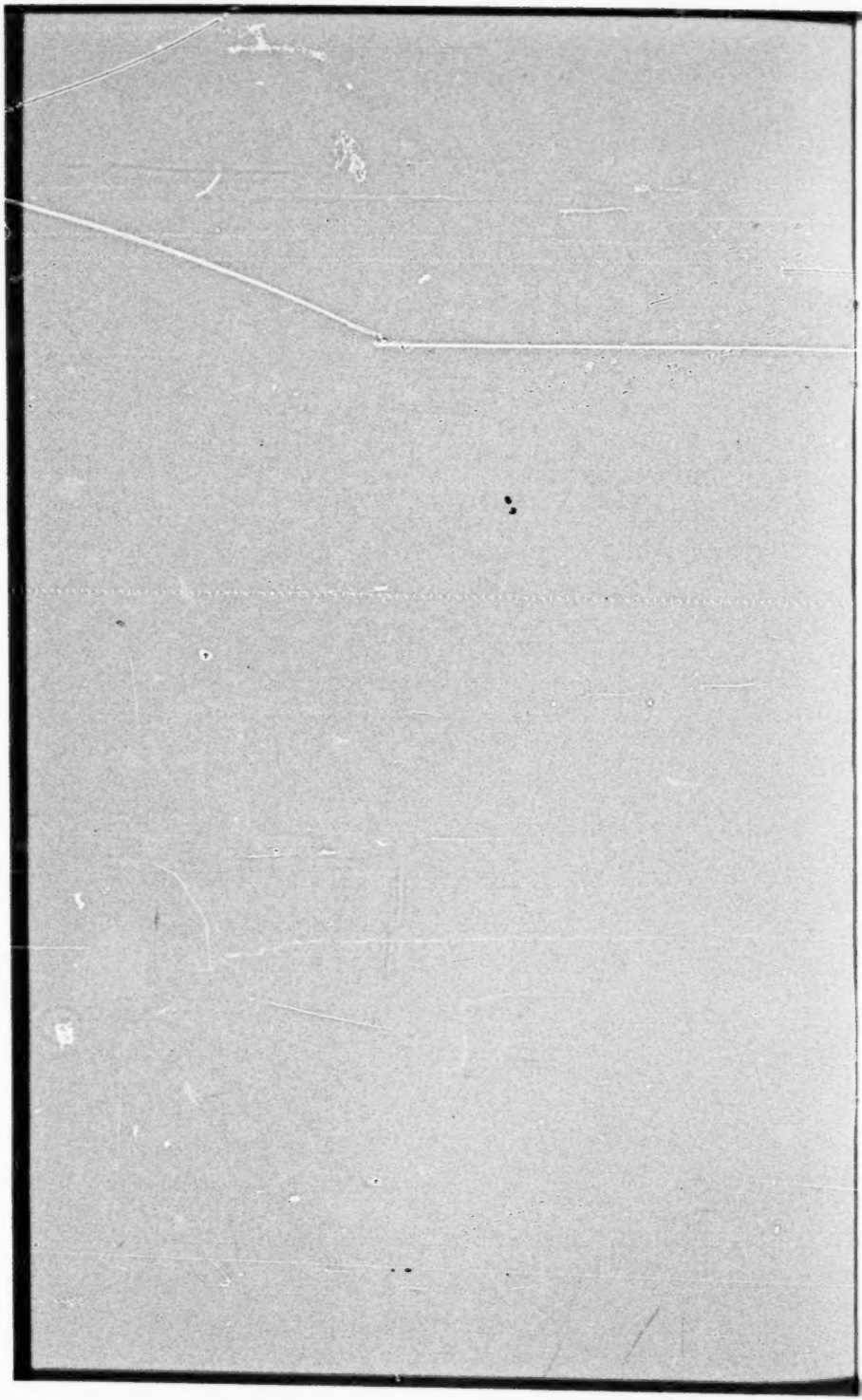

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1. THE PETITION FOR CERTIORARI CLEARLY SETS FORTH REASONS FOR THE GRANTING OF THE WRIT WHICH ARE CONTEMPLATED BY RULE 19

Respondents contend ". . . The case is without precedential significance and that none of the criteria set forth in Rule 19 is applicable." Respondents' brief 14, 15.

Although the Petition does not specifically cite Rule 19, the Petition does plainly declare that the decision below of the Sixth Circuit Court of Appeals, ". . . decided an important question of Federal law which has not been, but should be settled by this Court;" Rule 19 (1) (b).

Both the restrictive application of federal securities law and the form of denial of trial by jury are important questions of federal law.

2. THE RESTRICTIVE APPLICATION OF FEDERAL SECURITIES LAW IS A QUESTION OF PUBLIC IMPORTANCE

Respondents' brief focuses attention upon the role of the petitioners at the time of the stock transaction. Respondents emphasize the knowledge that the petitioners could have gained through investigation. The effect is to put the victims on trial.

This focus of attention upon the petitioners serves to direct attention away from the role of the respondent corporation.

The Sixth Circuit decision, despite respondents' derogation of it as "without precedential significance", stands now as the latest authority on the subject of disclosure in a direct corporation-shareholder securities transaction.

The decision absolves the corporation from any responsibility to its shareholder. Rather than promoting full disclosure, the decision is an open invitation to insiders to take advantage of their superior knowledge in dealing with non-management shareholders.

Ordinarily, a shareholder will have faith that management will act in the best interest of all the shareholders. In this case, Essex management at the time of the 1961 transaction had certain goals. These goals were to maintain management stock control; to keep stock out of the hands of outsiders; and to acquire any stock of non-management shareholders that could be acquired. These goals were freely acknowledged by Respondent Probst, Essex's President, at the trial of this case. Naturally, non-management shareholders, such as the petitioners were not privy to these goals.

Acquisition of the stock of outside shareholders, such as the petitioners, was a corporate objective of Essex management. Since the corporate management objective was antagonistic to the interest of the shareholders, it is small wonder that management chose not to inform the petitioners of anything that would cause them to hesitate, to further inquire, or to evaluate more carefully the eagerness of the corporate management to acquire their stock for the corporation to the benefit of corporate insiders.

This case squarely presents the question of when does the soliciting corporate management have a duty to its shareholders not to "stand mute."[1]

In *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), this Court addressed the question of "duty". There it was said that the defendants could not "stand mute" under the circumstances of that case.

The Circuit Court below ignored the discussion of "duty" in *Ute Citizens* and relegated a unanimous decision of this Court to two obscure footnotes. Both footnotes 6 and 7 of the Circuit Court opinion brush aside *Ute Citizens* as an "inapposite" case.

Petitioners submit that the totality of the circumstances of this case sound a much stronger call for the recognition of a "duty" not to "stand mute" than the circumstances of *Ute Citizens*. The stronger call here emerges from a comparison of the relationship of the parties in the two cases.

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1. Already one illustration of a recognition of the public importance of the unsettled legal principles involved in this case has been reported out of the School of Law of Case Western Reserve University. A substantial part of the final examination in the subject of Business Associations II (corporation and securities law) was devoted to a question which set forth the facts of this case from the opinion of the Court of Appeals, including the names of the parties. The question then called for the "comment" of the law student.

In *Ute Citizens*, this Court affirmed the action of the Circuit Court in holding the defendants liable for purchases made for their own accounts and for the stock purchased for resale at the higher price in "riskless transactions." But, *Ute Citizens* went further and held that the silence of the defendants violated S.E.C. Rule 10b5 in the transactions where the defendants were the agents for the purchases because of the "market maker" function of the defendants. The propriety of such result is obvious as a corollary of the familiar shingle theory of Professor Louis Loss, wherein a quality of a fiduciary relationship is recognized from statutory securities law even though neither an agency relationship nor a fiduciary relationship would exist at common law.

By comparison, in the present case there existed a full-blown fiduciary relationship of magnitude and long standing tradition in the law. This fiduciary relationship arises from management using the corporation in a dealing with an outside shareholder. The reach of S.E.C. Rule 10b5 certainly extends to management using the corporation to deal with a shareholder to purchase that shareholder's stock at a fraction of book net asset value without *actual* disclosure to the shareholder.[2]

Another appropriate comparison involves the familiar "insider" purchase from an outsider at a fraction of book net asset value. There the insider benefits himself. Whereas the situation where management uses the corporation to

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2. The public importance of the legal principles involved in this case is again illustrated by the final examination question at Case Western Reserve School of Law. After reciting the facts of this case from the Circuit Court opinion, the students were called upon to "comment". The circumstances of this case are a classic illustration to consider not only the reach of S.E.C. Rule 10b5 within the congressional intent of 15 U.S.C. 78j, but also the application of the Rule within the frame of traditional concepts of management responsibilty to minority outside shareholders.

repurchase stock involves another duty irrespective of self-dealing. That is the duty of management not to use the corporation to extend partiality to a class of shareholders. In this case, the purchase from the petitioners for $350.00 per share of stock, the book value of which was over $759.46 per share benefitted a class of shareholders to the detriment of the Petitioners.[3]

It is accordingly submitted that this case is of precedential significance; that the criteria set forth in Rule 19 are present; and that the Writ of Certiorari should be granted.

3. THE PROCEDURES BY WHICH PETITIONERS WERE DENIED A TRIAL BY JURY INVOLVED A QUESTION OF PUBLIC IMPORTANCE

The respondents' brief places the Seventh Amendment question of denial of trial by jury in an Alice in Wonderland atmosphere. The respondents choose a point in the midst of the proceedings, and then trace the procedures backwards.

This case began and concluded in the trial court with the Petitioners' allegation that the defendants had violated S.E.C. Rule 10b5 in dealing with the Petitioners. This case began with the demand by Petitioners for trial by jury of the federal cause of action.

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3. Neither the opinions of the District Court nor the opinion of the Circuit Court mention the book value of $759.46. The opinion of the Circuit Court does note that "appellants allege" the book value was more than double the $350.00 which was offered. The source of the book value figure is the prospectus which was published by Essex when it went public (a trial exhibit). That prospectus set forth the book value as of January 1, 1961, prior to the $350.00 per share transaction, as being $759.46 per share.

The case got off the track on the jury trial question when the district court ordered petitioners to file amended pleadings *eliminating* the cause of action based upon violation of S.E.C. Rule 10b5. The petitioners' exception to that ruling would certainly have been the subject for an appeal except for the district court ruling after the evidence had been presented and the case was over.

The Alice in Wonderland quality arises from the respondents saying that Petitioners did not object to the "mode of trial." It was respondents who objected to the "mode of trial" by jury. The district court sustained the respondents' objection.

Then the district court reinstated the federal question thereby precluding Petitioners from assigning as error that the district court was wrong to eliminate the federal cause of action, and wrong to deny a jury trial. Only the latter was subject to appeal.

Respondents contend that the petitioners should have moved for trial by jury at the conclusion of the evidence, and, by not so doing consented to the trial court resolving the credibility of witnesses and conflicts of evidence upon the S.E.C. Rule 10b5 cause of action.

Both the Circuit Court and respondents imply that Petitioners should have said something to invoke the obligation of the district court to empanel a jury. It is hypothetically submitted that such would have approximated the following:

> "May it please the Court. We realize that the taking of testimony, exhibits, and stipulations has concluded, but you have now said that you *may* decide to reinstate the Federal cause of action."

"Since you *may* decide to reinstate that Federal cause of action, plaintiffs renew their demand for trial by jury."

"The plaintiffs further move that all the witnesses be recalled for reexamination in the presence of the jury in order that the jury may evaluate the important question of the credibility of the witnesses."

The foregoing hypothetical illustration demonstrates the sophistic quality of the respondents' insistence that the petitioners omission of such a speech at the conclusion of the evidence was equal to a waiver of trial by jury.

It is accordingly submitted that the criteria set forth in Rule 19 are present. The Writ of Certiorari should be granted.

CONCLUSION

Both the question of whether S.E.C. Rule 10b5 was properly applied and the question of whether the Petitioners were deprived of the Seventh Amendment right to a trial by jury meet the criteria of Rule 19.

The grant of the Writ of Certiorari is therefore requested.

Respectfully submitted,

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and

ROBERT W. JONES

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